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27 FEB 1984

MEMORANDUM FOR: (See Addressee List)

FROM:

[Redacted]

Director of Global Issues

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SUBJECT:

Gray Market Arms Scams (U)

1. The attached memorandum examines several fraudulent gray market arms deals and suggests a methodology for distinguishing these scams from legitimate arms offers. [Redacted]

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2. This memorandum was prepared by [Redacted] International Security Issues Division, Office of Global Issues. [Redacted]

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3. Your comments and suggestions on this memorandum are welcome and may be addressed to the Chief, Weapons Proliferation Branch, OGI [Redacted]

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[Redacted]

Attachment:

Gray Market Arms Scams [Redacted]

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GI M 84-10038, February 1984 [Redacted]

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[Redacted]

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[Redacted]

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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

February 1984

## GRAY MARKET ARMS SCAMS [REDACTED]

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Summary

The international gray arms market is used to facilitate the purchase and movement of weapons on other than a government-to-government basis. Large quantities of infantry weapons, munitions, and other expendables are routinely available. The gray arms market also lends itself to the perpetration of a variety of fraudulent deals. These deals--or scams--frequently involve small-time or disreputable brokers operating under the cover of several front firms. Such brokers usually offer unrealistically high quantities of virtually unobtainable equipment and may seek to abscond with large advance downpayments or substitute less sophisticated ordnance at a later date. Iran--at war with Iraq and having few reliable military suppliers--has often been the target for many of these gray market arms scams. For example, some private arms dealers have offered advanced weapons such as Exocet missiles and Cobra helicopters to Iran, even though these

This memorandum was prepared by [REDACTED] International Security Issues Division, Office of Global Issues. This analysis is based on information as of 15 February 1984. Comments and queries are welcome and may be addressed to the Chief, Weapons Proliferation Branch, OGI [REDACTED]

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dealers do not have access to such equipment. Reports of such offers complicate efforts to monitor the transfer of military equipment and to ensure that exported US ordnance is not transshipped to a third party without the prior approval of the US Government. [REDACTED]

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Because of its secretive nature, the international gray arms market is used by recognized governments, established manufacturers, private dealers, and a variety of terrorist, insurgent, and criminal groups to buy and sell large quantities of weapons through unofficial--and often illegal--channels. The weapons most commonly traded on the gray market are small arms, although [REDACTED] heavy machineguns, recoilless rifles, and mortars as well as a wide variety of artillery munitions, telecommunications equipment, and spare parts are also available. In addition to such equipment, however, gray market dealers have also sought to broker the sale of large quantities of such advanced weapon systems as Exocet missiles and Cobra helicopter gunships, [REDACTED]

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[REDACTED] Offers for this kind of expensive material have traditionally been made to pariah states--such as Libya and South Africa--or to embargoed nations at war--such as Argentina during the Falkland crisis. Recently, many such offers have been made to Iran, which has been one of the most active buyers on the international gray arms market since the beginning of the war with Iraq. [REDACTED]

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#### Recognizing Scams

Gray market scams frequently exhibit one or more discernable characteristics. While any offer of large quantities of hard-to-obtain ordnance should be viewed with skepticism, the offer of such equipment by a small, obscure firm or individual is even more suspicious. [REDACTED]

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Individual arms brokers offering weapons on behalf of several firms are also suspicious. Small-time dealers probably negotiate on behalf of allegedly different firms in order to impress clients with the scope of their contacts or to maintain access to a potential buyer after an initial deal has fallen through.

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Similarly, cases of two or more firms operating out of the same office are suspect. Gray market swindlers may establish phony intermediaries and front companies in order to insulate themselves from a customer who may seek revenge after realizing that he has been cheated. Multiple firms at the same address are even more suspicious when the firms claim a foreign incorporation that cannot easily be verified.

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Another good indication that a gray arms negotiation may be a scam is the request on the part of the supplier for a large downpayment prior to the delivery of any goods.

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Similarly, another indication of a possible scam is the request for a large downpayment coupled with a long delivery schedule--intended, no doubt, to allow the broker sufficient time to abscond with his money.

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In addition to requesting long delivery schedules, gray market dealers seeking to set up a scam will frequently attempt to convince the client of the need to act quickly either by claiming that his own option to buy will expire soon or by implying that the equipment could end up in an opponent's possession.

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Offers of both hard-to-obtain and readily available equipment suggest that some dealers may seek to "bait-and-switch", by seeking a downpayment for hard-to-acquire, advanced ordnance in the hope of supplying other, less sophisticated equipment at a later date.

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#### Iran: A Target for Scams

At the outbreak of the war with Iraq, Iran was not in a position to acquire all of its military needs on a government-to-government basis, [redacted] The revolutionary government had halted practically all official arms buying activity, and established procurement channels had been abandoned. As a result of the loss of traditional contacts with the United States and Europe, an embargoed Iran entered the international gray arms market, where hundreds of private dealers and would-be agents offered to broker the sale of all manner of military equipment for the new regime. [redacted]

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Although arms dealers from Hong Kong to Pakistan have attempted to sell arms to Iran, most appear to reside or operate in West European countries such as Portugal, Spain, West Germany, Austria, and especially, Switzerland--the latter presumably because of its prominence as an international banking center and

its favorable incorporation laws. Some offers from these dealers appear credible and involve relatively small quantities of small arms, munitions, and other expendables which are readily available on the international gray arms market. Other offers appear to be frauds, however, with small-time--often disreputable--dealers proffering unrealistically large quantities of sophisticated and virtually unobtainable weapon systems at exorbitant prices.

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Although we do not know how much money Iran has lost as a result of fraudulent gray market deals, we believe that the amount was at least \$100 million by the end of 1982.

While we expect that gray market dealers will continue to offer advanced military equipment to Iran, we believe that Iranian procurement officers are becoming sufficiently cautious to discriminate between credible and improbable offers. We expect that gray arms market brokers will continue supplying conventional small arms and munitions to Iran as well as to any other client with sufficient cash to pay for them. They are unlikely, however, to find another customer willing and able to advance them large sums of money in return for the promise of advanced equipment--until the next international crisis or arms embargo creates a seller's market for such ordnance.

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SUBJECT: Gray Market Arms Scams [REDACTED]

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OGI/ISID/WP [REDACTED] (24 Feb 84

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Next 9 Page(s) In Document Denied